



2015-060

STATE OF ALABAMA
OFFICE OF THE ATTORNEY GENERAL

LUTHER STRANGE
ATTORNEY GENERAL

August 13, 2015

501 WASHINGTON AVENUE
P.O. BOX 300152
MONTGOMERY, AL 36130-0152
(334) 242-7300
WWW.AGO.ALABAMA.GOV

Honorable Tony Sanks
Escambia County Administrator
Post Office Box 848
Brewton, Alabama 36427

County Commissions – Investments – Trust
Income

The trustees of the Escambia County Oil and Gas Severance Trust Fund (“Trust”) may not invest the corpus of the Trust in an annuity.

The trustees of the Escambia County Oil and Gas Severance Trust Fund may not invest the corpus of the Trust in an Exchange-Traded Fund or Mutual Fund unless each and every security contained therein is, and continues to be, eligible as collateral for the Security for Alabama Funds Enhancement program as defined in section 41-14-35 of the Code of Alabama.

Capital gains of the Escambia County Oil and Gas Severance Trust Fund should be included as income of the Trust.

Dear Mr. Sanks:

This opinion of the Attorney General is issued in response to your request on behalf of the Escambia County Commission.

QUESTION

(1) May the Escambia County Oil and Gas Severance Trust Fund be invested in annuities, exchange-traded funds, and mutual funds?

FACTS AND ANALYSIS

Sections 40-20-1 through 40-20-50 of the Code provide for the collection and distribution of oil and gas severance taxes. ALA. CODE §§ 40-20-1 to 40-20-50 (2011). A portion of these taxes are distributed to the counties. ALA. CODE § 40-20-8 (2011). Pursuant to local law, Escambia County places its share of the oil and gas severance taxes in the Escambia County Oil and Gas Severance Trust. ALA. CODE § 45-27-246.30 (2011).

In 2014, the voters ratified an amendment to the Alabama Constitution dealing with the Trust. ALA. CONST. LOCAL AMENDS., ESCAMBIA County § 1.50 (amend. 885). The amendment provides, in part, that the Escambia County Commission may borrow money from the Trust for economic development, road and bridge repair, and other capital projects. *Id.* Additionally, “[t]he trustees may invest the trust funds in other investments as otherwise provided by local law and any prior local law authorizing the investment of trust funds is ratified and confirmed.” *Id.*

The local laws applicable to the Trust were originally adopted in 1984, but have been amended several times. 1984 Ala. Acts No. 84-576, 1198, now codified as ALA. CODE § 45-27-246.30 (2011). The act, as originally enacted, only authorized the Trust to be invested in “direct general obligations the payment of principal of and interest on which are unconditionally and irrevocably guaranteed by, the United States of America” and certificates of deposit. *Id.* at § 3. The original act also limited the duration of the Trust to 20 years. *Id.*

Act 87-445 made the Trust perpetual unless terminated by a majority vote of the qualified electors of the county. 1987 Ala. Acts No. 87-445, 660. Act 2003-266 expanded the available investment options by providing that the trustees “shall invest the corpus of the trust either *directly or indirectly* in securities otherwise eligible for the Security for Alabama Funds Enhancement (“SAFE”) program as defined in section 41-14-35, Code of Alabama 1975.” 2003 Ala. Acts No. 2003-266 (emphasis added).

Thus, the corpus of the Trust may be invested in certificates of deposit and, either directly or indirectly, in securities eligible as collateral for the SAFE program as defined in section 41-14-35 of the Code. *Id.* Section 41-14-35 of the Code describes the permissible types of investments as follows:

Direct obligations of the State of Alabama or any other state of the United States; obligations of the United States government or that are fully guaranteed as to payment of principal and interest by the United States; obligations

issued or guaranteed by any agency or instrumentality of the United States, including, without limitation, the Government National Mortgage Association or any successor thereto, any Federal Farm Credit Bank or any successor thereto, the Federal Housing Finance Board or any successor thereto, the Federal Home Loan Bank System or any successor thereto, or any Federal Home Loan Bank or any successor thereto; debt obligations, including, without limitation, participation certificates of the Federal Home Loan Mortgage Corporation or any successor thereto or of the Federal National Mortgage Corporation or any successor thereto; subject to the approval of the State Treasurer and compliance with all related requirements, conditions, and procedures established by the State Treasurer or the Board of Directors of the SAFE Program established under Chapter 14A, irrevocable, unconditional letters of credit issued by any Federal Home Loan Bank on behalf of a qualified public depository and naming the State Treasurer as beneficiary; any direct obligations of any agency, political subdivision, or instrumentality of the State of Alabama, including, without limitation, any direct obligation of any county or municipality, which carries the full faith and credit of the issuing entity; general obligations of any county, municipality, agency, political subdivision, or instrumentality of any of the various other states of the United States, which have a rating of "A2" or better by Moody's Investors Service (or any successor to that firm) or of "A" or better by Standard & Poor's (or any successor to that firm) or Fitch Ratings (or any successor to that firm); any revenue obligation issued by the State of Alabama or any agency, political subdivision, instrumentality, county, municipality, or district thereof, or by any authority, board, or public corporation of the State of Alabama or any such agency, political subdivision, instrumentality, county, municipality, or district, payable from designated taxes or from revenues or other limited or special sources of funds derived from any public facility or project which either (1) has a current rating of "A2" or better by Moody's Investors Service (or any successor to that firm) or of "A" or better by Standard & Poor's (or any successor to that firm) or Fitch Ratings (or any successor to that firm), or (2) has an average annual debt service coverage of at least two times; and mortgage-backed securities, collateralized mortgage

obligations, and asset-backed securities (excluding, however, mortgage-backed securities, collateralized mortgage obligations, and asset-backed securities constituting inverse floaters, interest-only strips, principal-only strips, or similar leveraged derivative instruments), issued by any public entity or organization, quasi-public entity or organization, or private entity or organization, provided that, except in the case of mortgage-backed securities, collateralized mortgage obligations, and asset-backed securities issued by an agency or instrumentality of the United States or any federally chartered or sponsored quasi-public entity or organization (including the Federal National Mortgage Corporation or the Federal Home Loan Mortgage Corporation), such securities or obligations shall have a current rating of "AAA" by Moody's Investors Service (or any successor to that firm) or of "AAA" by Standard & Poor's (or any successor to that firm) or Fitch Ratings (or any successor to that firm).

ALA. CODE § 41-14-35(a) (2013). Moreover, the State Treasurer is authorized to disapprove any security or instrument offered as collateral if the "State Treasurer determines that the security or investment is not sufficiently marketable." ALA. CODE § 41-14-35(c) (2013). A listing of eligible securities is available online, <www.treasury.state.al.us/content/Documents/SAFE%20Eligible%20Collateral.pdf>.

Your request references various types of investment vehicles such as annuities, exchange-traded funds ("ETF"), and mutual funds, and you question whether it is permissible to utilize these investment vehicles to invest the corpus of the Trust. As noted in a previous opinion to Honorable Frank Riddick, this Office views determinations of whether specific investments are authorized as a determination of fact. Opinion to Honorable Frank H. Riddick, Probate Judge, Madison County, dated July 28, 1998, A.G. No. 98-00190. Accordingly, we are not able to specifically address each of the investment scenarios outlined in your request. Nonetheless, we can offer the following general observations.

As noted previously, the corpus of the Trust may be invested either directly or indirectly in securities and instruments that are eligible as collateral in the SAFE program. Unfortunately, section 45-27-246.30 of the Code does not define "directly" or "indirectly." Generally, however, direct investments involve the purchase of physical assets of an entity. International Dimensions of U.S. Securities Law, § 2:5. Indirect equity investments, on the other hand, involve the purchase and sale of portfolio investments. *Id.*

The web site of the U.S. Securities and Exchange Commission offers the following helpful definitions that shed light on what is contemplated by indirect investments:

Exchange-Traded Fund (ETF)

A type of exchange-traded investment product that must register with the SEC as either an open-end investment company (generally known as “funds”) or a unit investment trust. ETFs offer investors a way to pool their money in a fund that makes *investments in* stocks, *bonds*, or other assets and, in return, to receive an interest in that investment pool. ETF shares are traded on a national stock exchange.

U.S. Securities and Exchange Commission, Glossary, <Investor.gov/glossary/glossary_terms/exchange-traded-fund-etf> (last visited August 13, 2015) (emphasis added).

Mutual Fund

The common name for an open-end investment company. Like other types of investment companies, mutual funds pool money from many investors and *invest* the money *in* stocks, *bonds*, short-term money-market instruments, or other securities. Mutual funds issue redeemable shares that investors buy directly from the fund or through a broker for the fund instead of from other investors.

U.S. Securities and Exchange Commission, Glossary, <Investor.gov/glossary/glossary_terms/mutual-fund> (last visited August 13, 2015) (emphasis added).

Annuity

An annuity is a *contract* between you and an insurance company, under which you make a lump-sum payment or series of payments. In return, the insurer agrees to make periodic payments to you beginning immediately or at some future date.

U.S. Securities and Exchange Commission, Glossary, <Investor.gov/glossary/glossary_terms/annuity> (last visited August 13, 2015) (emphasis added).

Based on these definitions, it is the opinion of this Office that mutual funds and ETFs are indirect investments. Thus, investment of the corpus of the Trust in either of these vehicles is permissible provided that each and every security and instrument comprising the mutual fund or ETF is eligible as collateral for the SAFE program.

The Alabama Securities Commission, however, has advised this Office that the number of ETFs and mutual funds that will continuously be composed exclusively of eligible collateral for the SAFE program is extremely limited. Moreover, routine changes of investment composition within those options, once purchased, might cause the investment to be out of compliance with the statute. To ensure compliance with the statute, almost daily monitoring would likely be required.

Although mutual funds and ETFs may be permissible, an annuity is a contract with an insurance company. *Id.* Thus, it is not an indirect investment in securities and instruments that are eligible as collateral for the SAFE program. An annuity may include components of investment in securities, but an annuity does not endow the investor with title to the security or instrument. *See* ALA. CODE § 8-6-2(10) (2002) (annuity contract issued by insurance company is not a security).

CONCLUSION

The trustees of the Escambia County Oil and Gas Severance Trust Fund may not invest the corpus of the Trust in an annuity.

The trustees of the Escambia County Oil and Gas Severance Trust Fund may not invest the corpus of the Trust in an Exchange-Traded Fund or Mutual Fund unless each and every security contained therein is, and continues to be, eligible as collateral for the Security for Alabama Funds Enhancement program as defined in section 41-14-35 of the Code.

QUESTION

(2) Should capital gains of the Trust be treated as income of the Trust?

FACTS AND ANALYSIS

This Office has addressed similar questions in previous opinions relative to the Alabama Trust Fund. *See, e.g.*, opinion to Honorable Kay Ivey, State Treasurer, State Treasurer's Office, dated January 5, 2011, A.G. No. 2011-025; opinion to Honorable Kay Ivey, State Treasurer, State Treasurer's Office, dated August 24, 2011, A.G. No. 2010-098; opinion to Honorable George C. Wallace, Governor, dated May 1, 1986, A.G. No. 86-00239. The analysis in those opinions, however, revolved around the specific definitions of terms such as "realized capital gains," "unrealized capital gains," and "trust income" appearing within the constitutional and statutory authorizations for the establishment of the Alabama Trust Fund. *Id.* No such definitions, however, appear within the legislation authorizing the establishment of the Trust. ALA. CONST. LOCAL AMENDS., ESCAMBIA County § 1.50 (amend. 885); ALA. CONST. LOCAL AMENDS., ESCAMBIA County § 2 (amend. 536); ALA. CODE § 45-27-246.30 (2011).

Of course, "[i]n interpreting as statute, the primary rule of statutory construction is that the intent of the Legislature should be given effect. Where possible, the intent should be ascertained from the plain language of the statute." Opinion to Honorable Kay Ivey, State Treasurer, State Treasurer's Office, dated September 26, 2006, A.G. No. 2006-152 at 1.

Section 45-27-246.30 of the Code, as amended, provides that "the corpus of the Trust . . . is to be composed of four million dollars (\$4,000,000) . . . paid to Escambia County during fiscal year 1983-84 together with 20 percent of the annual income thereon each year during the existence of this trust beginning with the fiscal year 1984-85." ALA. CODE § 45-27-246.30(a) (2011). This section further provides that "[b]eginning with the fiscal year 1984-85, up to 80 percent of the income from investments shall be distributed quarterly, semi-annually, or annually as designated by the trustees to the General Fund of Escambia County." ALA. CODE § 45-27-246.30(d) (2011).

We are aware that capital gains are often treated differently for income tax purposes. ALA. CODE § 40-18-8 (2011). We find no indication, however, that the Legislature intended to treat capital gains of the Trust any differently than any other type of income. Indeed, "income" often includes capital gains. *Wellborn v. Wellborn*, 100 So. 3d 1122, 1128 (Ala. 2012). Accordingly, we conclude that capital gains of the Trust should be included as income of the Trust.

CONCLUSION

Capital gains of the Escambia County Oil and Gas Severance Trust Fund should be included as income of the Trust.

I hope this opinion answers your questions. If this Office can be of further assistance, please contact Ben Baxley of my staff.

Sincerely,

LUTHER STRANGE
Attorney General

By:

A handwritten signature in cursive script that reads "Brenda F. Smith".

BRENDA F. SMITH
Chief, Opinions Division